Central Bank Weekly May 20th: Previewing FOMC Minutes, RBNZ, BoK, CBRT; reviewing PBoC, ECB minutes, SARB

20th May 2022:

FOMC MINUTES (WED): The Federal Reserve's May policy announcement was in keeping with market expectations. It lifted the Federal Funds Rate target by a 50bps increment to 0.75-1.00%, while the statement continued to suggest the Committee anticipates that "ongoing" rate rises will be appropriate. At the post-meeting press conference, Chair Powell leaned back against calls that the Fed could lift rates in 75bps increments, stating that the Committee was not actively considering hikes of that magnitude, and arguing that 50bps moves at the next "couple" of meetings was likely to be appropriate. The Committee also announced a phased-in start to balance sheet normalisation beginning in June (some were expecting the process to begin in May); the maximum monthly caps will start at USD 30bln and USD 17.5bln for Treasuries and MBS respectively, ramping up to USD 60bln and USD 35bln over three-months. Powell said the effects of balance sheet reduction were uncertain, but there are estimates that it could deliver the equivalent of a 25bps hike over the course of a year, perhaps biasing the neutral rate to the low-end of forecasts. The Fed alluded to the negative GDP print in Q1, saying that although overall economic activity edged down, household spending and business fixed investment remained strong. Chair Powell is also confident that the Fed can engineer a soft economic landing as it lifts rates in the face of a growth slowdown, though he constantly caveated the challenges the central bank would face in that endeavour. Powell was dismissive about the prospects of an outright recession, and he said that there was nothing in the economy that suggests it was close to a recession, though that was not to mean there will not be some slowing of growth. On the notion that the Fed could lift policy above estimates of the neutral rate – something economists say will begin to restrict economic activity from the current accommodative stance – Chair Powell repeated that the Committee would not hesitate to hike above that level (which the Committee sees between 2-3%), but said that this was not a decision to be made now, implying he was in the camp that favoured raising rates to neutral and then assessing the magnitude to which further rate rises were needed. Since the meeting, financial markets have seen episodes of sharp risk-off amid concerns about global inflation and a slowing growth impulse. Some had expected Fed officials to dial-down hawkishness in order to cushion the unwarranted tightening of financial conditions engineered by the sharp risk-off, however, key officials have not gone down this route; hawks like Bullard appear to be in line with the consensus of 50bps rate rises at the June and July meetings, while doves like Evans do not appear to be wavering as risk assets slide, all suggesting that the central bank would stay its course in tightening policy for now. One of the key emerging debates seems to be focussed on what the Fed will do when it gets rates to neutral: will it pause the hikes and assess the situation, or will it revert to shallower 25bps increments rate lifts. Chair Powell this week reiterated the case that the Fed would continue with hikes until inflation was back at target. Given the Fed's challenge in dealing with high inflation, this line from Powell is to be expected – backing away from it now risks undoing the initial work in lowering inflation expectations. However, analysts will be looking to the minutes for any hints on how the Fed could inject dovishness while staying the course regarding normalisation; analysts have speculated that the Fed might be able to project some dovishness by alluding to a lower terminal rate in this cycle, pausing when rates get to neutral; it could even suggest that the need for a larger 75bps increment hike was lower.

RBNZ RATE DECISION (WED): RBNZ will decide on rates next week in which it is expected to continue its hiking cycle as most analysts anticipate a 50bps increase by the central bank and OIS fully price in a 25bps hike with around a 90% probability of a greater 50bps move. The RBNZ has hiked rates for the past 4 consecutive meetings and even surprised markets in April with a larger than expected increase of 50bps (exp. 25bps), while it stated at the past meeting that it will remain focused on ensuring current high consumer price inflation does not become embedded into longer-term inflation expectations and monetary tightening was brought forward, but noted it remains comfortable with the outlook on the OCR as outlined in the February MPS. This suggests the central bank's more aggressive move in April was just front loading and its view for the actual destination of rates remains unchanged in which it had previously forecast the OCR at 2.84% in June 2023 and at 3.35% in March 2025. Nonetheless, the RBNZ is likely to continue the front loading with Westpac expecting three more 50bps rate hikes, while ASB Bank and Kiwibank are also calling for a 50bps hike at the upcoming meeting with the argument for tighter policy supported by inflation data after New Zealand CPI for Q1 rose at its fastest pace in 32 years.

BOK RATE DECISION (THU): The Bank of Korea's rate decision is scheduled for Thursday with the BoK likely to continue its hiking cycle and lift the 7-Day Repo Rate by 25bps to 1.75% from the current 1.50% level in its first meeting under the stewardship of newly-appointed Governor Rhee. As a reminder, the BoK defied consensus for a pause at last month’s meeting and surprised markets by unanimously opting for a 25bps rate hike with policy makers unwilling to wait for the formal appointment of a Governor to resume their fight against inflation. This decisiveness to tighten policy is expected to continue during Governor Rhee’s term as he previously noted that the BoK should continue hike rates unless it poses a problem for growth and stated that household debt needs to slow via ongoing tightening, while he also kept the door open to the possibility of a future 50bp move, which he suggested they will be able to determine if required after seeing the data for July-August. Furthermore, BoK Governor Rhee and Finance Minister Choo recently agreed to boost policy coordination to fight inflation and market instability, while the latest inflation data supports calls for a hike after CPI in April continued to outpace expectations and printed at its fastest increase since 2008, at 4.8% vs exp. 4.4% (prev. 4.1%).

CBRT ANNOUNCEMENT (THU): The CBRT is expected to maintain its One-Week Repo Rate at 14.00%. Desks note that the overall visibility and predictability of the central bank are low as recent policy decisions have not been based on conventional economic factors. Nonetheless, inflation remains high – April’s CPI metrics topped expectations, rising to 69.97% Y/Y from 61.14%, whilst PPI printed at an eye-watering 121.82% Y/Y from the prior 114.97%. “The MPC is currently monitoring the ‘cumulative impact of the recent policy decisions’, which suggests to us that it will likely remain on hold in the foreseeable future”, analysts at Credit Suisse said, adding that “authorities will probably continue to implement ad hoc measures as long as they can in order to sustain what we view as this ultimately unsustainable policy stance.” CS expects headline inflation to move towards 60-70% in the coming months and believes that the timing of a switch back to conventional policy hinges on politics as presidential/parliamentary elections will be held no later than mid-2023.

ECB MINUTES REVIEW: The account of the ECB’s April meeting was always likely to be deemed as stale by the market given how far the narrative surrounding the Bank has evolved since with a July 1st conclusion for APP and July 21st deposit hike very much the consensus. In terms of the content of the minutes, concerns were voiced over the inflationary outlook whereby it was noted that “there were increasing signs that the current high inflation was becoming entrenched in expectations, with a number of indicators of longer-term inflation expectations at least starting to become unanchored from the ECB’s inflation target”. Accordingly, some members viewed it as important to act without undue delay in order to demonstrate the Governing Council’s determination to achieve price stability in the medium term. In terms of specific policy actions, it was noted that if the upside risks to the inflation outlook were confirmed in the June Eurosystem staff macroeconomic projections, the Governing Council would face the question of whether continuing net purchases beyond June could still be seen as proportionate. From a rates perspective, some members viewed the higher-than-expected inflation figure in March and inflation expectations moving above the 2% target as requiring an adjustment of the monetary policy stance towards a neutral position sooner rather than later. As such, an increase in interest rates was touted as a possibility shortly after the conclusion of APP. In terms of the pace of hikes, it was recalled that the expected path of the nominal key ECB interest rates would approach a neutral level only at a very late stage of the policy normalisation process. From a growth perspective, it was underlined that, overall, the incoming data suggested that the Ukraine war would slow the recovery but not derail it, unless a less likely “tail” scenario materialised.

PBOC LPR REVIEW: The PBoC maintained its 1yr Loan Prime Rate at 3.70% (exp. 3.65%, prev. 3.70%) and cut its 5yr LPR to 4.45% (exp. 4.60%, prev. 4.60%). Although expectations were for a cut to the benchmark 1yr rate, the central bank's decision to keep it unchanged wasn't too surprising as the PBoC had maintained the 1yr MLF rate earlier this week and given that the central bank would likely want to avoid further exacerbating the recent currency weakness. Similarly, the surprise reduction to the 5yr rate, which is the reference for mortgages, may not be much of a shock given that China's financial authorities permitted a further reduction in mortgage loan rates for some home buyers last Sunday whereby commercial banks can reduce the lower limit by 20bps based on the corresponding tenor of benchmark Loan Prime Rates for the purchase of first homes.

SARB REVIEW: The South Africa Reserve Bank voted 4-1 to raise the Repo Rate to 4.75% (exp. 4.75%, prev. 4.25%); one member voted for a smaller 25bps rate hike. The Central Bank revised its growth view lower for 2022 (now sees 1.7% vs 2.0% previously). It also lifted inflation projections, and sees CPI averaging 5.9% this year (prev. view 5.8%), 5.0% in 2023 (prev. view 4.6%) 4.7% in 2024 (prev. view 4.6%); for core inflation, it sees an average of 3.9% this year (prev. view 4.2%), 5.1% in 2023 (prev. 5.0%), and 4.4% in 2024 (prev. 4.7%). The SARB said that alongside FX depreciation, other risks to the inflation outlook include elevated food and fuel prices, and that while food prices will stay high, fuel prices should ease next year. But it also warned that higher diesel and coal costs may result in upward revisions to its electricity price forecast next year. Capital Economics believes "MPC members' fears about inflation expectations becoming unanchored contributed to the decision to raise the pace of tightening," noting that inflation expectations were rising and are well above the Central Bank's 4.5% target mid-point. "Governor Kganyago said that the SARB considers domestic and global factors in its decision making and the global shift towards more hawkish monetary policy is likely to have played a key role as well," CapEco writes, "the Fed upped the pace of its tightening cycle earlier this month, and policymakers in South Africa probably don't want to lag too far behind their peers in advanced and emerging economies." CapEco sees the SARB raising rates by a further 50bps before reverting back to 25bps increments given that inflation is likely to breach the upper bound of the target range in Q2. But CapEco says "price pressures will probably ease over the second half of this year, and we expect the headline inflation rate to drop to the target mid-point by year-end," while "the economic recovery is unlikely to gain momentum as power outages and austerity continue to bite." CapEco is modelling 175bps of rate hikes to 6.5% by the end of 2023, though it notes that view is more benign than market expectations for 250bps tightening.